#77.400 10/12/76

First Supplement to Memorandum 76-83

Subject: Study 77.400 - Nonprofit Corporations (General Reaction to Tentative Recommendation; Basic Approach of Tentative Recommendation)

Attached to this supplement is the last page of Exhibit XXXXVII (the first five pages of which were attached to Memorandum 76-83). Also attached as exhibits are additional letters commenting on the tentative draft. (See Exhibits LXII-LXXI.)

General Reaction to Tentative Recommendation

Exhibit LXII believes the tentative recommendation "is excellent in most respects" but disagrees with several of the Commission's specific proposals. Exhibit LXIII wishes "to commend the Committee on its very fine job in compiling this much-needed set of Regulations governing nonprofit corporations." See also Exhibits LXX ("we would like to commend the Commission for doing an excellent job in preparing a comprehensive nonprofit corporation law for use in California.") and LXXI ("I think the recommendations relating to the Non-Profit Corporation Law are very well done"). See also the discussion under "Basic Approach of Tentative Recommendation" below.

Basic Approach of Tentative Recommendation

Exhibit LXVIII is an interesting letter from Professor Stanley Siegel, U.C.L.A. Law School, who served as the draftsman for the Michigan Law Revision Commission in preparing the Michigan Business Corporation Law and is assisting in an advisory capacity in the initial efforts of the Commission to develop a revised nonprofit law for the state of Michigan. He reports on the Michigan experience and his conclusion and reactions to our tentative recommendation as follows:

> Although the Michigan efforts have a considerable way to go, a Bar Committee is now in the process of developing initial drafts. A relevance of this to the California experience is that it was first thought that the nonprofit law should be built upon the Business Corporation Law, incorporating by reference or cross referencing where appropriate the operative provisions of that statute. After considerable effort, the Bar Committee concluded that the most workable approach would be to draft an entirely new

statute. Although the Law Revision Commission has yet to consider the matter, it is my impression that it, too, has concluded that the most effective way of dealing with the problems of nonprofit corporations is to give them the dignity of a separate statute. The likelihood is, of course, that such a separate act would borrow heavily from the provisions in Michigan's Revised Business Corporation Law.

Accordingly, expressing my own view only, I must agree that the approach adopted by the California Law Revision Commission appears to be the most promising for structuring the new act. Moreover, I favor the approach of adding a separate division with provisions applicable to corporations generally. Such provisions as definitions, corporate names, and filing provisions should not vary from one corporate form to another. Accordingly, there is statutory economy, particularly where the possibility of future amendments is contemplated, in providing a separate division encompassing these sections. The alternative of duplicating identical provisions in each of the applicable statutes appears unnecessary and leaves open the possibility that in subsequent amendment of one act a legislative oversight will leave the other act in unexpected and undesirable conflict with the first.

By way of contrast, Professor Jerry Kasner, University of Santa Clara Law School, who indicates that he did not have adequate time to review the materials because August was a vacation month for his family, objects:

> [T]o the removal of provisions relating to corporations generally from the business corporation law. One of the purposes of that revision was to provide a cohesive and logical sequence of statutes for the use of the practitioner. The removal of some provisions restores the confusion that generally results from extensive cross-referencing. Since by far the greatest number of corporations will be formed under the general corporation law, I believe that law should be preserved intact, and that the cross-referencing be accomplished by references in the nonprofit corporation law to applicable provisions of the general corporation law.

The provisions to be compiled in Division 4 do not relate to the internal affairs of business corporations so that the business corporation law and nonprofit corporation law will be complete in themselves under the Commission's proposal. A person interested in business corporations will need Division 1 and Division 4 and any other relevant provisions such as the fees provided in the Government Code, certain provisions in the Revenue and Taxation Code, provisions in the Code of Civil Procedure, and the like. Professor Kasner's suggestion that the nonprofit

corporation law cross-reference over to the relevant provisions of the General Corporation Law was not favored by the persons commencing on the tentative draft.

Other comments vary. Exhibit LXIII ("I'm certainly in accord with the Commission's basic approach since there has been a crying need for a nonprofit corporation law that is complete in itself and does not require reference to the business corporation law."), LXIV ("due to other pressing professional activities I have been unable to devote the necessary time to an evaluation of the proposals. I am not in favor of the basic approach of the tentative draft because I believe it needlessly complicates the law and would lead to the possibility of conflicting interpretations and unnecessary disputes. In addition, I would feel that there should be closer coordination with the income tax laws, both state and federal, as well as the sales tax and real property tax laws since frequently there are significant disputes in those areas."), LXVI ("the concept of the recommendation is one we support. Nonprofit corporations often rely on volunteer legal assistance and to the extent the proposed change makes the work involved in providing such assistance less burdensome by collecting the law in one place in an organized fashion and reflecting the current case law in the area it should enable such assistance to be more readily obtainable and to increase the benefit of the services that are obtained."), LXVII ("I do concur with your basic approach of both comprehensive nonprofit corporation law and a new division which will be applicable to all corporations."), LXXI ("I agree that there should be a separately stated Non-Profit Corporation Law, as the present interrelationship of the General Corporation Law and Non-Profit Corporations is impossible to work with for most California Non-Profit Corporations.").

Respectfully submitted,

John H. DeMoully
Executive Secretary

organized for charitable purposes from those provisions. We think that that is excellent. However, this section would still allow a non-profit organization, but which held charitable assets, to dissolve and avoid dissolution by purchase and the Attorney General may never find out about it. I would suggest that this article and the previous ones mentioned above, particularly Section 6011 on notice of sale or disposition of substantially all assets of a non-profit corporation, be meshed together in some way. If an organization is disposing of its assets as part of or as a prelude to a plan of dissolution or otherwise disappearing, it is our view that that should be brought to the attention of the Attorney General. I have no precise language to offer at this time, but we would very much like to work with anyone on this subject.

19. Section 6773 carries over the old former Section 9801 disposition of assets held on trust by a charitable corporation, and then adds a new provision allowing disposition without decree of Superior Court if the Attorney General makes a written waiver of objections to the disposition. We recommended this latter provision and we are delighted to see that it has been added. We feel that it is an excellent provision and should make the problems of dissolutions of charitable corporations much simpler.

As I go through this code again, I will undoubtedly have more comments. But again, I think that the approach is excellent and I think that the commission has a commendable job.

Very truly yours,

WARREN J. ABBOTT

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1st supp Memo 76-83 EXHIBIT LXII

95064-4115 THE UNIVERSITY OF SANTA CLARA • CALIFORNIA

September 27, 1976

State of California
California Law Revision Commission
Stanford Law School
Stanford, California 94305

Attention: Mr. John H. DeMoully,
Executive Secretary

Dear Mr. DeMoully:

In response to your letter of September 22, I would point out that the materials consisting of over 600 pages were sent to me on July 29, 1976, with comments due September 15, 1976. August was a vacation month for many families, including mine. I believe you will not receive much in the way of meaningful comments from persons who are given such an unreasonably short period of time to review such complex material.

I believe the tentative recommendation is excellent in most respects. To the extent possible, nonprofit corporations should be administered under statutes similar or identical to the business corporation law. The practical reason for this opinion is that attorneys who become involved in nonprofit corporations are generally also involved in business corporate tax practice, and should be able to bring the expertise acquired in the business corporate area to bear in the nonprofit corporate area. Nonprofit corporations frequently do not generate much in the way of fees for attorneys, so most of them can hardly be expected to develop great expertise in a totally different set of rules for nonprofit corporations. Finally, many of the provisions of the general corporation law relating to such matters as rights of shareholders, disclosure of information, inspection, voting, etc. are put there for the protection of the shareholder and the public. Experience has shown that abuses of these rights can occur in nonprofit corporations, and there is every reason to extend the same protection to their members and to the public. The concept of accountability of management should apply equally to all corporations.

State of California
California Law Revision Commission
Stanford Law School
Stanford, California 94305

Attention: Mr. John H. DeMoully

I do specifically disagree with two of the proposals. In view of the proprietory nature of many membership interests in nonprofit corporations, which the proposed legislation recognizes in many respects, I do not believe membership rights should terminate upon death unless otherwise provided in the articles of bylaws. I believe the opposite should be the case, i.e., a full right to succeed to membership rights unless otherwise specified in the articles. The new liberal rules on redemption of memberships can be used to avoid succession at death problems. On that same point, what about the community interests of a husband and wife in memberships if the community dissolves by termination of the marriage or death?

Secondly, I believe all nonprofit corporations should be required to furnish some form of annual financial or fiscal statement to all members at no cost. The 5% limit proposed is elitist. The cost can be handled through membership dues or assessments. Public policy should favor greater rather than less disclosure of the affairs of all corporations.

In the interest of membership disclosure, I believe all nonprofit corporations should be required to furnish to all members a summary of membership rights relating to such matters as voting, transfer, redemption, liquidation, assessment, etc. Possibly this summary could be made a part of the membership certificate and such a certificate required for all memberships.

I applaud the attempt to reduce the number of "special" nonprofit corporations and would hope that even more the special classifications could be eliminated.

Finally, I object to the removal of provisions relating to corporations generally from the business corporation law. One of the purposes of that revision was to provide a cohesive and logical body of statutes for the use of the practitioner. The removal of some provisions restores the confusion that generally results from extensive cross-referencing. Since by far the greatest number of corporations will be formed under the general corporation law, I believe that law should be preserved intact, and that the cross-referencing be accomplished by references in the nonprofit corporation law to applicable provisions of the general corporation law.

I hope these comments will be of some use.

Sincerely,

Jerry A. Kasner
Professor of Law

JAK:sc

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October 4, 1976

John H. DeMoully
Executive Secretary
California Law Revision
Commission
Stanford Law School
Stanford, California 94305

Re: Nonprofit Corporation Law

Dear Mr. DeMoully:

I'm certainly in accord with the Commission's basic approach since there has been a crying need for a nonprofit corporation law that is complete in itself and does not require reference to the business corporation law.

I'm certainly delighted to see archaic provisions relating to special corporations, such as charitable and eleemosynary, deleted.

Now as to specific Section comments:

§ 5250. Required contents of articles

This Section appears to prohibit the statement of the actual purpose of the corporation. I think this is unwise. I think the statement of identification of the general purpose of the corporation should be permitted in the Articles. Frequently, a statement of purpose in the Articles is required in the case of a chapter of a national organization.

Furthermore, I would think that the Attorney General would require some identification of purpose in order to categorize and follow up on nonprofit corporations (I'm hopeful of avoiding duplication in reporting separately to the Attorney General).

§ 5241. Validity of contracts or conveyances generally
§ 5242. Instrument signed by certain officers valid absent actual knowledge of lack of authority

In my opinion, these Sections are too broad. This is particularly true if the corporation is prohibited from stating its purpose in the Articles. I have a real concern with public charities which are tantamount to public trusts. These Sections appear to give authority to even an assistant secretary or treasurer to bind the corporation on any transaction unless the party on the other side has actual knowledge of the lack of authority.

First of all, assistant secretaries and treasurers in large public charitable organizations are usually low-rank staff people. Secondly, vice presidencies are oftentimes an honor. Rarely more than two or three of the volunteer officers are actively involved enough in the affairs of the organization to know what they're signing.

I feel these Sections are overly protective of financial and commercial organizations dealing with nonprofit corporations because I think at a very minimum the people dealing with a nonprofit corporation, particularly with low-rank officers, should be required to make a reasonable inquiry as to the authority of the officers signing the document to bind the institution.

One further consideration is the effect these Sections will have on fidelity bond premiums.

§ 5311. Number of directors

The flexibility in the number of directors to be fixed by the board is commendable. The old rule which this supersedes of board discretion within three board members was unworkable with large boards (public charities often have 25 to 100 memebers on the board of directors).

§ 5331. Call of meetings

Unless I missed something in some other Section limiting call of special meetings to be "ordered by the directors" is unduly limited, particularly for large boards. I would suggest permitting the chairman, president or a specified number of the members of the board, say 10%, to call meetings. In this day of increased director responsibility and participation, I think it is essential that board members, particularly minority board members, have a facility for calling meetings.

§ 5363. Resignation of officers

The resignation should be addressed to the chief executive officer unless he is the one resigning, in which case it should go to the next officer in line.

Article 8. Indemnification of Corporate Agents

I note under §5389(b) director may contract for indemnification to the extent of his liability as fiduciary of an employee benefit plan the extent permitted by law. I would suggest that this provision be expanded to cover all of the director's activities. I think the general indemnification provisions may be overly restrictive to the point of discouraging volunteer membership of leaders of the community on public boards. I think it's one thing to require strict standards with memberships on corporations where there are oftentimes direct and indirect financial benefits, but another consideration where membership is strictly voluntary for community benefit with no financial benefit to the board member. I think the rule should be less stringent for indemnification of board members on nonprofit corporations.

§ 5421. Options

How does this tie in which corporate securities law? Generally the whole provision on membership seems to apply more to private associations than it does public charities. Perhaps some delineation would be desirable.

§ 5441. Termination of membership

Subdivision (b) provides that no member may be expelled without due notice and a reasonable opportunity to be heard. I think this is fine for a private nonprofit corporation in which the members have financial interests, but I think its inapplicable to a public charity that may have thousands of members. I would urge that consideration be given to permitting nonprofit corporations to provide in their By-Laws for termination of membership for reasonable causes without a hearing where the member has no potential financial interest in the organization or its assets. For example, we commonly provide for termination of members in public charitable organizations for failure to attend meetings a specified number of times or assumption of some position which is in direct conflict with the purposes of the organization or inimical to it. I don't think that due process requires a hearing in that situation where the member does not have any vested interest in the organization.

§ 5443. Withdrawal of members

A 30-day written notice requirement is onerous on a member of a public nonprofit charity in which a member has no vested interest. I think a member should be entitled to withdraw at will upon written notice. This Section modifies the present rule that a member may withdraw at will or he has no vested interest or obligation.

I'm not sure of the Section, but I think the provision for members to inspect records is overly broad for public corporations in which the member has no vested interest. We have an increasing problem of strike suits by groups thinking personal gain rather than betterment of a particular organization.

§ 6772. Return of assets held on condition or by subordinate body.

Subdivision (b) I think deserves serious thought. This is a carry-over from existing law. It has been used as a club negotiating disengagement of local chapters of large national charities from a "parent" body. I think it may be illegal if applied in such a situation. I think that a volunteer group that has raised millions of dollars from local business should not be subject to forfeiture of its assets simply because it decides to disengage from the connection of a national organization. I think public charities should be exempted from this Section. Furthermore, I think that probably this Section should be limited to fraternal organizations and the forfeiture provisions only come into effect if all members and public contributors have notice that rights and assets contributed may be forfeited.

Again, I wish to commend the Committee on its very fine job in compiling this much-needed set of Regulations governing nonprofit corporations.

Sincerely,

William M. Poindexter

WMP:lu

1st supp Memo 76-83 EXHIBIT LXIV

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October 5, 1976

OUR FILE NUMBER
9911.00-1

John H. DeMoully, Esq.
Executive Secretary
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Standard Law School
Stanford, California 94305

Dear Mr. DeMoully:

I did receive the copy of Tentative Recommendation Relating to Nonprofit Corporation Law (July 26, 1976), but due to other pressing professional activities I have been unable to devote the necessary time to an evaluation of the proposals.

I am not in favor of the basic approach of the tentative draft because I believe it needlessly complicates the law and would lead to the possibility of conflicting interpretations and unnecessary disputes. In addition, I would feel that there should be closer coordination with the income tax laws, both state and federal, as well as the sales tax and real property tax laws since frequently there are significant disputes in those areas.

Yours sincerely,

Luther J. Avery

LJA:cet

LST SUPP Memo 76-83 EXHIBIT LXV

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October 6, 1976

John H. DeMoully
Executive Secretary
CALIFORNIA LAW REVISION COMMISSION
Stanford Law School
Stanford, Calif. 94305

RE: Non-Profit Corporation Law Comment - Installment Two

Dear John:

In spite of my best efforts I find that getting these comments off to you and having them typed is an installment process. Enclosed is substantially all of the statute, exdept your Part 2. I have previously sent you what I considered to be my important comments on the beginning portions of the statutes. I hope that this is of some help, and the latter portion I will try to get to you by early next week.

I am also enclosing an article which you and Nat might find interesting from the C.T. Corporation Journal on directors committees and some of the problems related to them. This relates to my earlier discussion with the Commission and you about the need for a statute permitting committees and attempting to relieve the rest of the board from certain responsibilities. It is evident that it is a problem in a corporation for business purposes as well. Perhaps some of these ideas can be of use and we can make one final change that will incorporate some of them.

Very truly yours,

G. Gervaise Davis III

3:dm
Encl.

COMMENTS ON NON-PROFIT CORPORATION DRAFT

Installment Two

CHAPTER VII - VOTING OF MEMBERSHIP

§ 5711. Subsection (a) is unclear without careful reading of the comment. I would suggest reversing this sentence so that it reads "pursuant to Chapter 6, at a meeting, or by written consent,...".

§ 5712. For some reason this Section still confuses me and it seems that one problem might be solved if you made a second reference to "or the class" in the third line after reference to the voting membership. I believe this statute is intended to mean that the by-laws may require or permit a vote by the membership or by a class of less then all of the members. It is not clear since the reference to voting members refers to members entitled to vote for directors by definition under §5184. Such a reference is confusing because that group of voting members is greater than a single class. Perhaps I am just obtuse.

§ 5713(a). In the second line do you mean "the members of a class" or "or a class". Subsection (b) would be clearer if in line 3 you were to refer to the class as "the designated," since reference to "class" is open to several interpretations.

§ 5714(b). Suggest that you add in this clause the word "additionally" so that it reads, "the By-laws may, additionally, require, etc.". This makes clearer the additive nature of this clause.

§ 5718(b). I just plain don't understand this Section which seems to me to say nothing but that the votes that are required are those that are required to vote.

§ 5719(b). I am concerned with the second sentence commencing with "only members representative of the membership" since I think this is an invitation to a law suit. I do not have any way of determining definitively or advising a client conclusively what the sentence means. I would prefer language to the effect that "all classes effected by policies to be set by the policy-making committee shall be represented on the committee."

§ 57199(c)(2). I cannot figure out what the clause "whom the member....represents" means. Does this refer to the class, to those who voted for him, or what? It seem ambiguous because I cannot tell how this representation is determined. I think one way to solve the problem in part would be to expand the comment to explain the purpose of the restrictions contained in subparagraphs (b) and (c). Personally, I would stop with subparagraph (a) and leave the remainder to the By-laws.

§ 5722. This may be the only solution to a standard problem, but query: 1. Can the minor disaffirm his vote on reaching majority, or is he bound by it forever? Why don't we say so in the statute; 2. Does this give the right to the minor to, for example, drink in the club, or should the statute say that he exercises these rights subject to other laws limiting his rights as a minor. Perhaps this is a matter to cover in the comment.

§ 5723(a). How does a corporation "designate" someone to vote. Is this a matter requiring board resolution or just oral authority given to an officer from the President. Perhaps we should specify in the statute or in the comment to avoid a potential problem. Normally, statutes provide that the President or a Vice-president may, by virtue of his office, vote the shares of another corporation on behalf of the corporation, unless the Board of Directors has provided otherwise. This seems sensible to me.

§ 5731. Is it merely implied that the attorney-in-fact must also sign his own name in his representative capacity, or should this be specified.

§ 5732(d). Does not subsection (d) provide a loop-hole to avoid subsection (a) entirely. The SEC will not let business corporations do this under any circumstances, and I know because I have tried.

§ 5733(b). Why reduce the proxy to three years from the seven years, as I do not see any rational basis for changing existing law. It is again a trap to the occasional practitioner.

§ 5740. Perhaps we should consider here the fact that the 1976 tax reform act now allows 15 shareholders for Subchapater-S Corporations, and unlimited expansion when the shares pass to new shareholders by virtue of inheritance. Perhaps this same principle should be incorporated here.

§ 5751(b). What does the last sentence of this mean when it refers to "at another election or vote"? How does it differ from a request made at a meeting.

§ 5762(b)(2). Where is an election by mail held -- at the place from which the ballots are mailed, the place where they are received, or the place where the majority of the shareholders vote the ballots.

CHAPTER 8 - DERIVATIVE ACTION

No Coments.

CHAPTER 9 - AMENDMENT OF ARTICLES.

As previously commented, I really would like to see the amendments to articles section moved up to join the articles chapter of the law since it has always seemed to me to be illogical to have amendments back at the end, when most of the amendments provide that you can do all sorts of things subject to the provisions for originally filing the articles. This simply means you have to refer to both sections and flip back and forth to figure out what they mean. To me this is illogical and the fact that it has historically been done this way is no reason to do it in our statute.

§ 5912. I do not understand the reason for the limitation about continued existence contained in the clause on lines three and four of subparagraph (a). What difference does it make if the corporation has continuously operated, and how would the Secretary of State know other than in the statement filed. This kind of thing is simply a trap since practitioners will then have to make the statement, will not know for sure whether their

clients have conformed and in the final analysis I do not see that it adds anything at all since they can always re-incorporate just as easily.

§ 5920. Do non-voting members have to vote on an amendment. The merger sections clearly indicate that only voting members are counted in votes on mergers. This is a vital question since in charities it may not be possible to reach all of the non-voting members, and I think the statute should make very clear by an express statement that only members entitled to vote for directors are required to vote on an amendment, if that is what you intend.

CHAPTER 10 - SALE OF ASSETS.

§ 6014(a)(2). I would add as a separate subparagraph (3) "if a charitable corporation, that the Attorney General notice has been given as required by §6012."

CHAPTER 11 - MERGER AND CONSOLIDATION.

§ 6124. Throughout this statute we have eliminated or modified the business law requirements on the basis that non-profit corporations cannot afford extensive legal expenses or other expenses. On that basis I do not feel we can justify inclusion of this section since it is merely an additional expense to the corporation in a case in which most instances the member will have no property interests in the transaction. The member is notified at the time of the vote on the matter and is entitled by law to find out what happened by making inquiry of the officers or directors. I therefore strongly urge that we delete this section along with its companion section later in the

provision on division of corporations (§6222).

§ 6141. I do not see, by definition, how a non-profit corporation can be subject to payment of franchise taxes. I think if you are going to keep this reference it should be to a certification or statement that the corporation has "filed all necessary returns to the Franchise Tax Board" or similar agencies. Again, I make this comment later with respect to division of corporations.

§ 6142. I think this section is an excellent idea and fills a major hole in the regulatory pattern of charitable organizations. I would suggest mechanically, however, that the last two and a half lines concerning the Secretary of State be set forth in a subparagraph (3) since the sentence is rather awkward as written.

§ 6151. The term "and continues to exist" etc. in line three seems awkward. Perhaps the tense of the verb "continues" is wrong. I am not certain that that is exactly what we mean, but perhaps it could be said as a separate sentence.

§ 6153(b). I would add to this statute reference to requirements for compliance with §6142 if the corporation is charitable.

§ 6160(b). I am philosophically opposed to subsection (b) in that I feel it raises many more problems than it solves and is an open invitation to a "strike" suit by an annoyed member. It is an overprotection of members rights, which merely suggests litigation. It is fairly evident that even absent such a statute a grossly unfair transaction will still be susceptible to court

review, but I do not think we should invite it. Please seriously consider omitting it.

CHAPTER 12 - DIVISIONS OF CORPORATIONS

§ 6220, § 6221, § 6222. It does not seem clear to me whether or not these matters have to be approved by all members, or only the voting members. As pointed out previously, this is an immense problem for charities splitting up since they cannot get the vote of non-voting members, most of whom are not carried on any membership lists. Perhaps it is the eventual reference back to §5712 that leaves this unclear to me. Would it not be simplier to state that the plan shall be approved by the "voting members" throughout these three sections.

§ 6222. This section is burdensome for no reason, as I previously commented with respect to §6124. This is not like a business corporation and I think it is completely unnecessary.

§ 6241. Same comment as made to §6141.

§ 6242. Same comment as made to §6142, as to need for dividing the last section into two subsections.

§ 6248. With reference to the idea of recording the plan, I do not see why we have this provision here but do not have it in the case of mergers and consolidations. It seems to me that the same problem exists in both cases and we should be consistent. I personally find it very convenient to have corporations meet this requirement, since title to property is therefore easier to trace and it does not require that we resort to the Secretary of State's office. In the case of non-profit corporations it would invariably involve only one county so that it is not particularly

burdensome. I know that business corporations dislike this section because many of them have to file in the numerous counties because the business corporations statute previously required filing in any place that the corporation held real estate. In other words, include it also in all of the mergers and dissolution sections.

§ 6260(b). Same comment as to §6160(b).

CHAPTER 13 - NONE

CHAPTER 14 - BANKRUPTCY

Generally speaking, I think it is an excellent idea to include this section as the matter was completely unclear under the previous law. I agree fully with our Berkeley professor friend and his letter as to these sections.

§ 6412. The last sentence of the comment seems inconsistent with our decision in §6448 above, on which I commented. Technically, I do not think we are talking about "filing" but recording of this information. As stated above, I personally believe we should require it in all cases, or in none. This kind of occurrence is fairly rare for non-profit corporations and I do not therefore think it is any particular burden, any more than it is in the case of mergers or divisions. Based on what the Secretary of State has told me the number of non-profit corporation mergers could be counted on the fingers of one hand in any one year.

(To Be Continued)

DIRECTORS' COMMITTEES

The full board of directors is an unwieldly instrument with which to manage the daily affairs of today's large business corporation. The variety and complexity of the decisions which must be made, many in areas requiring specialized knowledge and expertise, and the impossibility of assembling the board on short notice between the traditional monthly meetings to handle matters requiring prompt action, have forced the directors to delegate power to committees of the board. The liability of individual directors for actions taken by the board has forced them to rely upon the specialized knowledge of committees with jurisdiction over the areas concerned.

Committees of the board, because of their size, can more readily be convened to decide pressing issues in their specialized areas. A committee with responsibility for a particular area or areas of the corporation's affairs tends to build expertise among the directors serving on it. Where final decision can await the meeting of the full board, the report and recommendations of the committee with special knowledge in the area will often be the most reliable source of information available to the full board.

The complexity of corporate affairs has led to the establishment of a variety of committees, both standing or permanent committees and ad hoc committees with a limited existence established to report to the board on unusual and non-recurring matters. The executive committee is the most common standing committee, usually given jurisdiction over a variety of matters and not limited to one area of corporate affairs. Almost as common are audit committees, usually given the task of reviewing and monitoring the financial reporting of the corporation and its financial controls; compensation committees, which examine and recommend changes in the compensation of managerial level employees; and finance committees, which are concerned with financial decisions and financial planning. Although not as common, many corporations have established public interest committees, charitable contribution committees, investment committees, committees concerned with recommending candidates for the board of directors, with acquisitions and mergers, with shareholder relations, and a variety of others of an ad hoc nature.

The evolution of the directors' committee has not been without effect on the constitution of the board of directors itself. The establishment of committees with board-delegated responsibility in special areas has made it necessary to recruit for the board persons with knowledge and experience in these areas. And parallel to the evolution of the board committee has been the evolution of the law governing the powers of the board and their delegability. The establishment, growth and variety of board committees, the governing law, and the effect these have had on the responsibilities and liability of both committee-member and non-committee-member directors, will be considered below.

All states have in their statutes a statement to the effect that the business of a corporation will be managed by a board of directors. At

common law, there was some doubt as to the ability of a board of directors to delegate its powers. It was argued that the position of directors with respect to the corporation was like that of an agent to his principal. Thus, powers which were delegated to the directors could not be redelegated to an agent or committee.[1] This view was rejected in many cases which held that the board of directors of a corporation does not receive powers as an agent of the stockholders, but that its powers are original and undelegated, and therefore can be delegated to committees.[2] Although courts at first permitted the delegation of only routine "ministerial" tasks, they eventually extended the permissible range of delegable functions to include all duties in the ordinary business of the corporation.[3] It has been held that this limitation obtains even where the grant of power to the committee is ostensibly limitless, such as where it is stated that the committee has the full powers of the board of directors.

In *Hayes v. Canada, Atlantic & Plant S. S. Co. Ltd.*,[4] the court considered a bylaw of a corporation which permitted the directors to appoint an executive committee, and which stated that "said committee shall have full powers of the board of directors when said board is not in session." The court refused to give these words their literal meaning, speaking of "the impossibility of giving force to the words 'full power' in the by-law referred to except with limitations restricting them to the ordinary business transactions of the corporation." This case is typical of many others.[5]

Generally, powers which have been absolutely denied to committees by courts are "those involving the basic character and existence of the corporation, such as the amendment of articles, merger or consolidation, sale of assets or dissolution."[6] Courts have differed as to which other specific powers are non-delegable, as have legislatures in enacting the statutes discussed below.

The delegation of powers to committees made up of non-directors is not allowed, despite some ambiguous language in early cases. One reason for this is the general public policy which requires that a corporation be managed by persons selected by the shareholders, at least as to major discretionary decisions. In *Steigerwald v. A. M. Steigerwald Co.*,[7] the Appellate Court of Illinois stated that "the courts of this state have carefully preserved the power of stockholders to select those who shall control the corporations for them." The statutes of all but two states clearly require all committee members to be directors. The Hawaii statute is not explicit in that it merely allows a bylaw with

[1] See *Gillis v. Bailey*, 21 N. H. 149 (1850).

[2] *In re Lone Star Shipbuilding Co.*, 6 F. 2d 192 (C. C. A., 1925); *Hoyt v. Thompson's Executor*, 19 N. Y. 207 (1859); *Olcott v. Tioga Railroad Co.*, 27 N. Y. 546 (1863).

[3] *Hayes v. Canada, Atl. & Plant S. S. Co., Ltd.*, 181 F. 289 (1st Cir., 1910); *Maryland Trust Co. v. National Mechanics' Bank*, 102 Md. 606, 63 A. 70 (1906).

[4] 181 F. 289 (C. C. A., 1910).

[5] *Robinson v. Benbow*, 298 F. 881 (4th Cir., 1924); *Tracy v. Guthrie County Agr. Society*, 47 Iowa 27 (1877); *Maryland Trust Co. v. National Mechanics' Bank*, 102 Md. 606, 63 A. 70 (1906); *Ryder v. Bushnell R. R.*, 134 N. Y. 83, 31 N. E. 281 (1892); *Commercial Wood & Cement Co. v. Northampton Portland Cement Co.*, 190 N. Y. 1, 82 N. E. 730 (1907); *Feinterer v. Pressure Lighting Co.*, 149 N. Y. S. 49 (1914); *Doyle v. Chladek*, 401 P. 2d 18 (Oregon, 1965); *Tempel v. Dodge*, 69 Tex. 69, 32 S. W. 514 (1886).

[6] Model Business Corporation Act Annotated 2d § 42 ¶ 2.

[7] 132 N. E. 2d 373 (Ill., 1956).

respect to "the appointment of an executive committee . . . of the board of directors." The Tennessee statute states that members of only the executive committee need be directors. In addition, the new California Corporations Code, effective January 1, 1977, will permit a board to "delegate the management of the day-to-day operation of the business of the corporation to a management company or other person provided that the business and affairs of the corporation shall be managed and all corporate powers shall be exercised under the ultimate direction of the board." In the absence of statute, it has been held that a corporation cannot choose a non-director to be on a committee with directors for purposes of winding up the affairs of the corporation, and that a vote to constitute such a committee is void.[8]

All states now have statutes which permit the use of committees by the board of directors.[9] (A list of citations to these statutes appears at the end of this article.) Although many of these statutes are similar, the differences merit examination.

Section 42 of The Model Business Corporation Act, prepared by the Committee on Corporate Laws of the American Bar Association, provides that:

> "If the articles of incorporation or the by-laws so provide, the board of directors, by resolution adopted by a majority of the full board of directors, may designate from among its members an executive committee and one or more other committees each of which, to the extent provided in such resolution or in the articles of incorporation or the by-laws of the corporation, shall have and may exercise all the authority of the board of directors. . . ."

This section goes on to list certain powers which are forbidden to any committee. These include the ability to declare dividends, to approve or recommend to shareholders proposals which require shareholder approval, to designate candidates for the board of directors, to amend the bylaws, to approve a plan of merger, and to reduce earned or capital surplus.

Most states have adopted provisions similar to this one, but some statutes materially differ from it. For example, six states[10] specify that committees may exercise their powers only during the intervals between meetings of the full board. (It is likely that many courts would consider this to be an implied limitation in other states as well.)[11] Three states either require or permit more than a majority

[8] *Charlestown Boot & Shoe Co. v. Dunsmore*, 60 N. H. 85 (1880).

[9] The Arizona statute became effective July 1, 1976. The new Iowa Business Corporation Act, Iowa Code Annotated, Ch. 496A, contains such a provision, but Ch. 491, the old law which coexists with the new statute, does not. Iowa references will be to the new law. New Hampshire has no statute which specifically sets forth the manner of selecting committees or which states conditions for their use. However, it is provided that "The business of every business corporation shall be managed by its directors, subject to the bylaws and votes of the incorporators or stockholders, and, under their direction, by such officers, agents, or committees as shall be appointed by the directors or under authority conferred by them or by the corporation."

[10] Alabama, Arkansas, Minnesota, Ohio, Oklahoma and Wisconsin.

[11] See *Commercial Wood & Cement Co. v. Northampton Portland Cement Co.*, 190 N. Y. 1, 82 N. E. 730 (1907).

vote to form a committee: Connecticut permits the bylaws to require a greater vote, Minnesota requires a unanimous vote both to name a committee and to set the limits of its powers, and Oklahoma requires a unanimous vote to form a committee if there is no specific provision in the articles of incorporation or bylaws concerning such formation. Twelve states [12] apparently permit the use of committees unless the provisions of the articles of incorporation or bylaws expressly forbid it.

Other than those, the variations from the Model Act provision are fairly standard, with some states specifically providing for the formation of only one committee [13] and others declining to statutorily limit the permissible powers of committees.[14] In addition, several states include provisions concerning the selection of alternate members of committees and their participation in committee meetings.[15]

One point which is particularly crucial to a discussion of committees is the extent to which directors who are not on a committee may be held liable for its wrongful actions. As pointed out above, one reason for using committees in the first place is the fact that boards are becoming more diversified, and that directors often do not have the time to attend frequent meetings or even to maintain familiarity with the details of corporate management. Therefore, since one *raison d'être* for the committee is the lack of time of directors, the question of non-member directors' responsibility for committee actions and, therefore, of how much time and effort they must put into supervising the committee, is important.

Before it was amended in 1975, § 42 of the Model Act stated that "The designation of any . . . committee and the delegation thereto of authority shall not operate to relieve the board of directors, or any member thereof, of any responsibility imposed by law." Approximately two-thirds of the states have comparable provisions. The amended § 42 now provides that:

> "Neither the designation of any . . . committee, the delegation thereto of authority, nor action by such committee pursuant to such authority shall alone constitute compliance by any member of the board of directors, not a member of the committee in question, with his responsibility to act in good faith in a manner he reasonably believes to be in the best interests of the corporation, and with such care as an ordinarily prudent person in a like position would use under similar circumstances."

Maryland has adopted a comparable provision.

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[12] Alabama, Arizona, Florida, Idaho, Indiana, Kansas, Michigan, Minnesota, Nevada, North Carolina and Pennsylvania have specific statements to that effect. Delaware seems to allow this by making no reference to enabling provisions.

[13] Alaska, Arkansas, Colorado, District of Columbia, Idaho, Illinois, Minnesota, Missouri, North Dakota, Oklahoma, Oregon and South Dakota.

[14] Alabama, Alaska, Colorado, Connecticut, District of Columbia, Hawaii, Idaho, Louisiana, Minnesota, Missouri, Nevada, New Hampshire, North Dakota, Oklahoma, Pennsylvania and Utah. Tennessee states that certain powers may not be exercised by a committee unless specifically authorized by the board.

[15] Connecticut, Delaware, Florida, Georgia, Kansas, Louisiana, Maine, Maryland, Michigan, New York, Ohio, Pennsylvania, Tennessee and Wisconsin. Such a provision also appears in the new California Corporations Code, effective January 1, 1977.

Similarly, many states follow § 42 of the Model Act as it read p[rior] to its amendment in 1975 in permitting a director to rely and act in good faith "upon financial statements of the corporation represented to him to be correct by the president or the officer of such corporation having charge of its books of account" without incurring any personal liability if the actions taken would otherwise be wrongful. In 197[5], this provision was made a part of § 35 and broadened in scope. It now provides that "In performing his duties, a director shall be entitled to rely on information, opinions, reports or statements, including financial statements and other financial data . . . prepared or presented by . . . a committee of the board upon which he does not serve, duly designated in accordance with a provision of the articles of incorporation or the by-laws, as to matters within its designated authority, which committee the director reasonably believes to merit confidence. . . ." It is further provided that a director complying with this and other requirements of the subsection "shall have no liability by reason of being or having been a director of the corporation." Thus far, similar provisions have been incorporated in the Connecticut, Florida and Maryland statutes and in the California Corporations Code which takes effect January 1, 1977.

Several statutes require directors to exercise that degree of care which an ordinarily prudent man would exercise in his own affairs, as does the recently amended § 35 of the Model Act.[14] (Although most of the statutes do not specifically include the role of committee member within this requirement, it appears that the policy behind the provision would require such an interpretation.) Cases have also frequently prescribed similar standards.[15] Therefore, it would seem that directors are generally not liable for actions taken by committees of which they are not members so long as they are diligent enough to meet the "prudent person" test. In one recent case, *Kelly v. Bell*,[16] directors of U. S. Steel were sued by shareholders for not having supervised actions taken by certain directors and officers of the corporation. The court held that the absence of board approval for payments totalling nearly five million dollars annually was not carelessness on the part of directors, whether or not they knew of the payments. The vast size of the corporation's operations required the delegation of such decisions, and the failure of directors to learn of it was not wrongful.

[14] This is required by Connecticut, Florida, Georgia, Idaho, Iowa, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, New Jersey, New York, Oklahoma, Pennsylvania, South Carolina and Tennessee, and by the new California Corporation Code, effective January 1, 1977. Model Act § 35 was amended in 1975 to provide that:

"A director shall perform his duties as a director, including his duties as a member of any committee of the board upon which he may serve, in good faith, in a manner he reasonably believes to be in the best interests of the corporation, and with such care as an ordinarily prudent person in a like position would use under similar circumstances."

[15] *Barnhardt v. Northwestern Nat'l Bank*, 28 F. 2d 568 (9th Cir., 1930); *Atherton v. Anderson*, 99 F. 2d 883 (8th Cir., 1938); 89 Conn. 481, 94 A. 985 (1915); *Graham v. Allis Chalmers Mfg. Co.*, Del. Ch., 188 A. 2d 125 (1963); *Fisher v. Parr*, 92 Md. 245, 48 A. 821 (1901); *Greenfield Savings Bank v. Abercrombie*, 211 Mass. 252, 97 N. E. 887 (1912); *Martin v. Hardy*, 251 Mich. 413, 232 N. W. 197 (1930); *March v. Eastern R. Co.*, 43 N. H. 515 (1862); *Williams v. McKay*, 18 A. 824 (N. J., 1889); *Cassidy v. Uhlman*, 170 N. Y. 505, 63 N. E. 554 (1902); *Kavanaugh v. Gould*, 223 N. Y. 103, 119 N. E. 237 (1918).

[16] Del. Ch., 264 A. 2d 52 (1969).

It may also be relevant that the court held that the payments themselves were not wrongful; perhaps it would have been stricter otherwise.

One other aspect of this problem deserves attention: the question of the liability of directors who are members of committees either for actions taken at meetings which they did not attend or for actions taken when they did attend but with which they disagree. Section 35 of the Model Act states that:

> "A director of a corporation who is present at a meeting of its board of directors at which action on any corporate matter is taken shall be presumed to have assented to the action taken unless his dissent shall be entered in the minutes of the meeting or unless he shall file his written dissent to such action with the secretary of the meeting before the adjournment thereof or shall forward such dissent by registered mail to the secretary of the corporation immediately after the adjournment of the meeting. Such right to dissent shall not apply to a director who voted in favor of such action."

Most states have provisions similar to this one, with nine states [19] specifically extending the application of the section to meetings of committees of the board of directors. It would seem that the policy behind the basic provision could make it applicable to committee members with respect to committee actions even in the absence of such an explicit statutory extension.[20]

In addition, eight states [21] presume that directors who are absent from meetings assent to actions taken unless they record their dissents within a reasonable time after learning of the actions. Therefore, directors in those states must make their objections to wrongful actions known, even if they were not at the meeting where the actions were taken, to avoid possible liability.

One final point requiring examination is whether a committee can bind the corporation by its act alone. Only a handful of statutes cover this point. The Arkansas provision states that "An act or authorization of an act by the executive committee within the authority lawfully delegated to it shall be as effective for all purposes as the act or authorization of the directors. . . ." The North Carolina and Ohio statutes contain similar language. The Nevada statute states that: "Any contract or conveyance otherwise lawful, made in the name of a corporation which is authorized or ratified by the directors, or is done within the scope of the authority, actual or apparent, given by the directors, binds the corporation. . . ."

Many courts have held that a committee can bind the corporation.[22] Others have disagreed, but have held that corporations are

[19] Connecticut, Maine, Michigan, New Jersey, New York, Ohio, South Carolina, Tennessee and Wisconsin.

[20] See *De Vet's Inc. v. Ineull*, 122 F. 2d 755 (7th Cir., 1941); *March v. Eastern R. Co.*, 43 N. H. 515 (1862).

[21] Delaware, Kansas, Michigan, Nevada, New Jersey, New York, Pennsylvania and Tennessee. In some circumstances, South Carolina has a similar presumption.

[22] *Andres v. Fry*, 113 Cal. 124, 45 P. 534 (1896); *Storer v. Florida Sportservice, Inc.*, 135 So. 2d 908 (Fla., 1961); *Haldeman v. Haldeman*, 176 Ky. 535, 197 S. W. 378 (1917); *Cabot, Inc. v. Gas Products Co.*, 93 Mont. 497, 19 P. 2d 878 (1933); *Banker's*

bound by extraordinary committee actions through ratification[53] or through estoppel.[54]

It should be kept in mind that, while the committee is generally used to facilitate the management of a corporation, in the case of a divided board it can be used to deny to minority directors their right to share in such management. Since it usually takes only a majority vote of directors to form a committee, a majority vote which creates a committee which is composed of directors representing the majority interest, and which invests it with all the powers which the statute, bylaws and certificate permit, may disenfranchise minority directors and stockholders.

No cases appear in which this kind of maneuver was attempted, but it seems clear that courts would not support such a scheme. It would also appear that the opportunity for such a situation could be reduced through careful drafting of the certificate of incorporation and bylaws.

In summary, committees of boards of directors have become more important as problems have arisen with traditional boards and as courts and statutes have enlarged the scope of powers delegable to such committees to include, generally, all duties in the ordinary business of the corporation. These powers may be limited in the bylaws, the certificate of incorporation or by the resolution of the board which creates the committee. Directors who are not members of a committee may be liable for wrongful acts performed by it, since the delegation of powers does not end the responsibility of such directors, but the criterion which directors must satisfy to avoid liability is that they exercised the degree of care of an ordinary prudent man in his own affairs. Some statutes and cases state that committee actions bind the corporation without more, while others require ratification or estoppel.

It is possible to use a committee to gain complete control over the management of a corporation for a majority interest. The certificate of incorporation or bylaws should be carefully drawn, not only to minimize the possibility of misuse of committees, but also to tailor the powers of the committees to fit the needs of the corporation. If current trends continue, committees will grow in importance, and careful planning can enhance their usefulness to any board of directors.

The following is a list of statutes covering committees of boards of directors and related subjects discussed in the article above:

Alabama—Title 10, Secs. 21(29) and 21(31), Code of Alabama.

Alaska—Secs. 10.05.195, 10.05.219, and 10.05.222, Alaska Statutes.

Arizona—Secs. 10-042 and 10-048, Arizona Revised Statutes.

Arkansas—Secs. 64-306 and 64-308, Arkansas Statutes, 1947.

Money Order Ass'n v. Nachod, 12[illegible] App. Div. [illegible], 112 N. Y. S. 7[illegible] (1908); *Title Ins. Co. of Richmond v. Howell*, 158 Va. 713, 164 S. E. 387 (1932).

[53] *Kelsey v. New England Street Ry.*, 60 N. J. Eq. 230, 46 A. 1061 (1900); *Ryder v. Bushwick R. R.*, 134 N. Y. 83, 31 N. E. 251 (1892); *East Cleveland Ry. v. Everett*, 13 Ohio Cir. Ct. 152 (1896).

[54] *Tilden v. Goldy Mach. Co.*, 9 Cal. App. 9, 98 P. 39 (1908); *Metropolitan Telephone & Telegraph Co. v. Domestic Telephone & Telegraph Co.*, 44 N. J. Eq. 568, 14 A. 907 (1888); *Greensboro Gas Co. v. Home Oil & Gas Co.*, 222 Pa. 4, 70 A. 940 (1908).

California—Secs. 822, 825 and 829, California General Corporation Law (repealed as of January 1, 1977; Secs. 300, 309 and 311, California Corporations Code, effective January 1, 1977).

Colorado—Sec. 7-5-107, Colorado Revised Statutes, 1973.

Connecticut—Secs. 33-313, 33-318 and 33-321, Connecticut General Statutes Annotated.

Delaware—Title 8, Secs. 141 and 174, Delaware Code, Annotated.

District of Columbia—Secs. 29-916e and 29-918, District of Columbia Code Encyclopedia.

Florida—Secs. 607.111 and 607.127, West's Florida Statutes Annotated.

Georgia—Secs. 22-708, 22-713 and 22-715, Code of Georgia Annotated.

Hawaii—Sec. 416-80, Hawaii Revised Statutes.

Idaho—Secs. 30-129 and 30-142, Idaho Code.

Illinois—Secs. 157.38, 157.42-9 and 157.42-10, Smith-Hurd Illinois Annotated Statutes.

Indiana—Sec. 23-1-21-1, Burns Indiana Statutes Annotated.

Iowa—Secs. 496A.39 and 496A.44, Iowa Code Annotated.

Kansas—Secs. 17-6301 and 17-6424, Kansas Statutes Annotated.

Kentucky—Secs. 271A.210 and 271A.240, Baldwin's Kentucky Revised Statutes.

Louisiana—Secs. 12:81, 12:91 and 12:92, West's Louisiana Statutes Annotated.

Maine—Title 13A, Secs. 713, 716 and 720, Maine Revised Statutes Annotated.

Maryland—Secs. 2-405.1, 2-410 and 2-411, Annotated Code of Maryland, Corporations and Associations.

Massachusetts—Ch. 156B, Secs. 59 and 66, Massachusetts General Laws Annotated.

Michigan—Secs. 450.1527, 450.1528, 450.1541 and 450.1553, Michigan Compiled Laws Annotated.

Minnesota—Secs. 301.28 and 301.31, Minnesota Statutes Annotated.

Mississippi—Secs. 79-3-79 and 79-3-91, Mississippi Code 1972 Annotated.

Missouri—Secs. 351.330 and 351.345, Vernon's Annotated Missouri Statutes.

Montana—Secs. 15-2238 and 15-2242, Revised Codes of Montana, 1947.

Nebraska—Secs. 21-2041 and 21-2046, Revised Statutes of Nebraska, 1943.

Nevada—Secs. 78.125, 78.135, 78.295 and 78.300, Nevada Revised Statutes.

New Hampshire—Secs. 294:89 and 294:103, New Hampshire Revised Statutes Annotated, 1955.

New Jersey—Secs. 14A:6-9, 14A:6-13 and 14A:6-14, New Jersey Statutes Annotated.

New Mexico—Secs. 51-24-40 and 51-24-45.1, New Mexico Statutes Annotated.

New York—Secs. 712, 717 and 719, Business Corporation Law.

North Carolina—Secs. 55-31 and 55-32, General Statutes of North Carolina.

North Dakota—Secs. 10-19-42 and 10-19-47, North Dakota Century Code Annotated.

Ohio—Secs. 1701.63 and 1701.95, Page's Ohio Revised Code Annotated.

Oklahoma—Title 18, Secs. 1.34, 1.36 and 1.38, Oklahoma Statutes Annotated.

Oregon—Secs. 57.206 and 57.231, Oregon Revised Statutes.

Pennsylvania—Title 15, Secs. 1402, 1408 and 1707, Purdon's Pennsylvania Statutes Annotated.

Rhode Island—Secs. 7-1.1-38 and 7-1.1-43, General Laws of Rhode Island, 1956.

South Carolina—Secs. 12-18.11, 12-18.12, 12-18.15 and 12-18.19, Code of Laws of South Carolina, 1962.

South Dakota—Secs. 47-5-13, 47-5-14, 47-5-20 and 47-5-21, South Dakota Compiled Laws, 1967.

Tennessee—Secs. 48-810, 48-813 and 48-815, Tennessee Code Annotated.

Texas—Arts. 2.36 and 2.41, Vernon's Annotated Texas Statutes, Business Corporation Act.

Utah—Secs. 16-10-39 and 16-10-44, Utah Code Annotated, 1953.

Vermont—Title 11, Secs. 1886 and 1891, Vermont Statutes Annotated.

Virginia—Secs. 13.1-40 and 13.1-44, Code of Virginia, 1950.

Washington—Secs. 23A.08.400 and 23A.08.450, Revised Code of Washington Annotated.

West Virginia—Secs. 31-1-98 and 31-1-102, West Virginia Code Annotated.

Wisconsin—Secs. 180.36 and 180.40, West's Wisconsin Statutes Annotated.

Wyoming—Secs. 17-36.37 and 17-36.41, Wyoming Statutes, 1957.

STATE OF CALIFORNIA EDMUND G. BROWN JR., Governor

DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT
1807 - 13th Street, Sacramento, CA 95814
(916) 445-1802

October 6, 1976

Mr. John H. DeMoully
Executive Secretary
California Law Revision Commission
Stanford Law School
Stanford, CA 94305

Dear Mr. DeMoully:

I find myself in the awkward position of having to apologize to you for being unable to provide you with timely, substantive comments on the Commission's tentative recommendation relating to a new nonprofit corporation law. The press of departmental business over the past several months has been such that we have been unable to devote staff time to a close scrutiny of the recommendation although that had been our earlier intention.

There are several general observations, however, that we wish to make. In approaching our review of the recommendation, we asked our line program staff people to reflect on their experiences in dealing with nonprofits in the areas in which this department principally operates, viz., in housing, community, and economic development activities, and to identify problems encountered with nonprofits. The problems identified did not relate to the authority, powers, restrictions, or organization of nonprofits imposed by statute. As nonprofit corporations are common and important in the areas of housing, community and economic development, the absence of statutorily engendered problems in this department's experience may be a useful, even if limited, comment.

Additionally, the concept of the recommendation is one we support. Nonprofit corporations often rely on volunteer legal assistance and to the extent the proposed change makes the work involved in providing such assistance less burdensome by collecting the law in one place in an organized fashion and reflecting the current case law in the area it should enable such assistance to be more readily obtainable and to increase the benefit of the services that are obtained.

Finally, it is our experience that nonprofit corporations are often viewed as less substantial or serious undertakings than for-profit entities and as a consequence encounter problems in establishing the sort of credibility necessary to operate effectively in a business environment. We hope the attention to be focused on nonprofits through your recommendation and the creation of a separate and distinct law governing their operation will help to overcome that attitude.

We commend your efforts. We plan to follow the course of the recommendation through the legislative and will suggest changes based on our continuing experiences in dealing with nonprofits should that become necessary. Thank you.

Sincerely,

Robert A. Firmock
General Counsel

BS

First Supplement to
Memorandum 76-83

EXHIBIT LXVII

THOMAS H. BURCHAM
Attorney and Counselor at Law

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October 7, 1976

Mr. John H. DeMoully
Executive Secretary
State of California
California Law Revision Commission
Stanford Law School
Stanford, California 94305

Subject: Tentative Recommendation Relating to Nonprofit Corporation Law

Dear Mr. DeMoully:

I apologize for the delay in responding to your tentative recommendation.

I have only had an opportunity to review the drafts in some haste, but I do concur with your basic approach of both comprehensive nonprofit corporation law and a new division which will be applicable to all corporations.

As I read the individual provisions, it appeared they are aware of most of the problems and had attempted to reach some solution of them.

If I can be of assistance in commenting on specific details, please let me know.

Very truly yours,

Thomas H. Burcham

THB:ac

EXHIBIT LXVIII

UNIVERSITY OF CALIFORNIA, LOS ANGELES

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LOS ANGELES, CALIFORNIA 90024

October 6, 1976

John H. DeMoully
Executive Secretary
California Law Revision Commission
Stanford Law School
Stanford, CA 94305

Dear John:

Although I have not had an opportunity to complete a detailed review of the California Law Revision Comission's Tentative Recommendation Relating to Nonprofit Corporation Law, I have reviewed the general structure of the proposal and many of its provisions. As you may be aware, I served as the draftsman for the Michigan Law Revision Commission in preparing the Michigan Business Corporation Act, and I have assisted in an advisory capacity in the initial efforts of that Commission to develop a revised nonprofit law for the state of Michigan.

Although the Michigan efforts have a considerable way to go, a Bar Committee is now in the process of developing initial drafts. A relevance of this to the California experience is that it was first thought that the nonprofit law should be built upon the Business Corporation Law, incorporating by reference or cross referencing where appropriate the operative provisions of that statute. After considerable effort, the Bar Committee concluded that the most workable approach would be to draft an entirely new statute. Although the Law Revision Commission has yet to consider the matter, it is my impression that it, too, has concluded that the most effective way of dealing with the problems of nonprofit corporations is to give them the dignity of a separate statute. The likelihood is, of course, that such a separate act would borrow heavily from the provisions in Michigan's Revised Business Corporation Law.

Accordingly, expressing my own view only, I must agree that the approach adopted by the California Law Revision Commission appears to be the most promising for structuring the new act. Moreover, I favor the approach of adding a separate division with provisions applicable to corporations generally. Such provisions as definitions,

corporate names, and filing provisions should not vary from one corporate form to another. Accordingly, there is statutory economy, particularly where the possibility of future amendments is contemplated, in providing a separate division encompassing these sections. The alternative of duplicating identical provisions in each of the applicable statutes appears unnecessary and leaves open the possibility that in subsequent amendment of one act a legislative oversight will leave the other act in unexpected and undesirable conflict with the first.

I have been asked by the Michigan Law Revision Commission to review California's proposal for the purpose of determining whether many of its detailed provisions might be usable in Michigan's Revision. I am hopeful that I shall be able to complete this review in the near future, and I will send you a copy of my comments in the hope that they may prove of some value to the California Law Revision Commission as well.

I am grateful to you for keeping me posted on the developments in this area.

Sincerely,

Stanley Siegel

Stanley Siegel
Professor of Law

SS:mrs

First Supplement to
Memorandum 76-83

EXHIBIT LXVIX

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October 7, 1976

John H. DeMoully
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Stanford, California 94305

Dear Mr. DeMoully:

Please exuse my failure to repond to your letter of September 22, 1976, as well as my lack of communication regarding the proposed Nonprofit Law.

Upon receipt I immediately read the general approach which outlines the new law; however, because of a disabling illness I was unable to go any further and will not be able to proceed.

There is one comment I must make. I am sure this comment may have already been made, but if I am correct, it appears that the new law incorporates within its provisions all types of nonprofit corporations. If from my casual reading of the preface this is correct, I must express my disapproval. The difference in the concept, formation, operation, and management of a charitable nonprofit corporation as compared, lets say, to a mutual water company or a cooperative, is too divergent both as to the purpose and benefits to allow the same laws to apply. This is amply demonstrated by the present law as it applies generally to nonprofit corporations.

Thank you for the opportunity to examine and study the proposal. I intend, in some way, for my own edification, to continue to study the proposal and if I am able, will submit such other comments as I think would be helpful.

Very truly yours,

FIELDS, FEHN & FEINSTEIN

Irving F. Fields

IFF/crn

First Supplement to
Memorandum 76-63

EXHIBIT LXX

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October 6, 1976

John H. DeMoully
Executive Secretary
California Law Revision Commission
Stanford Law School
Stanford, California 94305

Dear Mr. DeMoully:

We are the attorneys for the California Hospital Association, the Association of Independent California Colleges and Universities, and various individual hospitals, associations, and nonprofit civic and cultural organizations. We have had an opportunity to review the California Law Revision Commission recommendation relating to a new Nonprofit Corporation Law and apologize for not providing you with our comments prior to this date. Initially, we would like to commend the Commission for doing an excellent job in preparing a comprehensive nonprofit corporation law for use in California. We have only a few observations that may be helpful in the final review of the recommendation.

(1) The new law refers to the governing board as directors consistent with the corporate law. Many nonprofit corporations designate their directors as trustees. This is so in colleges and universities, hospitals, cultural and trade associations, and we would recommend that provision be included in the law to permit the use of the term "trustee" interchangeably with that of "director."

(2) On page 67 of the detailed outline of the recommendation, there is a reference to certain advantageous provisions of special statutes and, in particular, Corporation Code section 10204 relating to the power of the Board to delegate financial and investment decision-making authority. There is an indication that such provisions would be included in the proposed nonprofit corporation law; however, we have been unable to determine where this provision has been included.

(3) The duty of care imposed upon directors of many nonprofit corporations embodies the same standard as imposed upon directors of profit-making corporations. However, we are concerned about the distinction with respect to the greater duty imposed upon charitable trustees. This could have a substantial adverse effect upon the operation of nonprofit hospitals within the state. We are certain that you recognize that most nonprofit hospitals operating in the state of California attempt to, and most have, secured an exemption from income tax under the provisions of 501(c)(3) of the Internal Revenue Code. The exemption is granted on the theory that these organizations are charitable in nature. If the duty of charitable trustees is imposed upon the directors of these corporations then we feel that there will be a widespread reluctance to serve -- particularly in view of the fact that in serving in such capacity most of the directors are not compensated. Accordingly, we would recommend that the standard of care for trustees for charitable purposes be limited to only those activities which require registration under the Uniform Supervision of Trustees for Charitable Purposes Act. Since hospitals are exempt from registration, this would resolve the problem. Another means of handling the problem would be to exempt from the standard of care for charitable trustees those directors who operate a business entity as the primary function of the corporation even though it be a charitable purpose under the Internal Revenue Code.

We hope that you will take these suggestions into consideration in your deliberations.

Very truly yours,

James E. Ludlam
for MUSICK, PEELER & GARRETT

JEL:jb

First Supplement to
Memorandum 76-83

EXHIBIT LXXI

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October 5, 1976

Mr. John H. DeMoully,
Executive Secretary
California Law Revision Commission
Stanford Law School
Stanford, California 94305

Dear Mr. DeMoully:

Thank you for your reminder of September 22, 1976. I had reviewed the entire draft and prepared some notes when it first arrived, but have not had an opportunity until now to dictate them.

I agree that there should be a separately stated Non-Profit Corporation Law, as the present interrelationship of the General Corporation Law and Non-Profit Corporations is impossible to work with for most California Non-Profit Corporations.

Let me make the following comments on the materials as I receive them:

Page 14: Some of the small Non-Profit Corporations in California have a difficult time limiting the execution of instruments by senior executive officers on behalf of the Non-Profit Corporation. I would like to see some requirements that there be authorization in writing by resolution of the Board of Directors for any executive officers except the president or chairman of the board to enter into binding contractual relations with third parties.

Page 15: The one oversight in the existing law, and continued in the proposed Non-Profit Corporation Law is that the term of a director is one year, or until a successor is elected and takes office. I would like to see the new Non-Profit Corporation Law include a provision that permits the board of directors to terminate a director for failure to attend any annual or regularly called meeting during the course of that year.

Page 21: Under existing law the president and secretary positions may not be held by the same person, but any two other offices can be held by the same person. Small Non-Profit Corporations in California generally use counter signature checks and I would like to see a provision that the president and treasurer positions not be held by the same person. Additionally, that no instruments of the corporation can be signed by the same person in more than one capacity.

Page 31: I would like to see a provision that special meetings may be called by any three directors whether they hold one-tenth of the voting power or less.

Page 63: Because Non-Profit Corporations for the most part provide governmental activities, such as education or social and welfare relief, an additional fee for performing this

social function aught not to be imposed on Non-Profit Corporations.

Page 72: I believe that the Government Code Section 12210 aught to be continued, without fee, for Non-Profit Corporations as previously set forth.

Page 90: No place in the Code do I find the definition of "member", and this should be provided at this point as Section 5152A.

Page 131: Section 5312 should provide, consistant with the foregoing, that each director should hold office "until the expiration of the term for which elected, the board declares a vacancy, or until a sucessor has been elected and qualified."

Page 135: Section 5321(a) I believe should read "... elected by the members at the annual meeting of members."

Page 144: Section 5336(b), In accordance with the previous discussion, I believe should read: "The by-Laws may provide that a quorum of directors is greater or less than a majority, but not less than one-third of those authorized to vote."

Page 163: Section 5380(a) (2) should read: "A foreign or another domestic Non-Profit Corporation, ..."

Page 167: Line 3, the word "ultimately" should not be inserted in there.

Page 178: Section 5424 should have an additional subsection (c) which requires the words "non transferable membership" be stamped on membership certificates where appropriate.

Page 216: Section 5563(b) makes it mandatory that a Non - Profit Corporation which is deemed to be "a private foundation" must distribute its income..."in such a manner as not to subject it to tax Section 4942 of the Internal Revenue Code of 1954." I think this is misleading in that it mandates that the private foundation not violate the Revenue Code of 1954, and I believe the intent of the Commission would be to make it directory, rather than mandatory. Secondly, under the Internal Revenue Code of 1976, private foundations are given a different treatment than under the Internal Revenue Code of 1954. Perhaps one solution would be to just simply indicate as follows: "... as not to unreasonably subject it to tax under the Internal Revenue Code."

Page 220: Section 5573 mandates by use of the word "shall" that the trustee of a common trust fund pay periodically dividens which equal the net income of the trust. I believe that inserting the words "when available" after the word "pay" in the second line of this section would clear up any ambiguity.

Page 340: Section 6411 grants specific powers to a Non-Profit Corporation which, may be contrary to Federal Bankruptcy Law. One solution would be to insert language which would permit the Non-Profit Corporation to do these things, "consistant with Federal Bankruptcy Law."

Page 384: Section 6720 permits a voluntary disolution of the Non-Profit Corporation by a simple majority of the membership. Because of the academic, and social services provided by Non-Profit Corporations, generally, I believe that it would be in

the best interest of Non-Profit entities for the vote to be three-quarters, rather than a simple majority of the members to begin a voluntary dissolution of the corporation. In this manner, a minority of members, who may wish to continue the function, purpose, and structure of the Non-Profit Corporation, would be able to carry on those activities without a hindrance of the majority at the time.

In spite of the foregoing comments, Mr. DeMoully, I think that the recommendations relating to the Non-Profit Corporation Law are very well done and I would be more than happy to work with the Commission in any capacity that you feel I might be of some service. Again, thank you for your reminder of September 22, 1976, and I trust that my comments reached the Commission before this is submitted after the Commission's October meeting.

Very truly yours,

Robert L. Hewitt

Robert L. Hewitt

RLH/ch